A GRAND UNION OF
ALL GOOD THINGS

GRAND UNION
SUPERMARKETS

The Grand Union Company

1977 Annual Report

Fiscal Year Ended
April 1, 1978

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Thomas R. Doyle
Executive Vice President and
Assistant to the President
The Grand Union Company

Sir James Goldsmith
Chairman of the Board,
Cavenham Limited

Bowman Gray III
President, General Occidental, Inc.

Hon. S. William Green
Member, U.S. House of
Representatives

Jack Greenhalgh
Executive Vice Chairman and
Managing Director,
Cavenham Limited

Michael L. Haynes
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Cavenham Limited

Dr. Rafael Picó
Vice Chairman,
Banco Popular de Puerto Rico

Arthur Ross
Vice Chairman and
Managing Director,
Central National Corporation

Lionel J. Ross
Financial Director,
Cavenham Limited

Earl R. Silvers, Jr.
Vice President and Secretary,
The Grand Union Company

James Wood
President and
Chief Executive Officer,
The Grand Union Company;
Joint Deputy Managing Director,
Cavenham Limited

Officers

James Wood
President and Chief Executive Officer

Thomas R. Doyle
Executive Vice President and
Assistant to the President

Patrick A. Deo
Executive Vice President and
Chief Operating Officer

Alan C. Goulding
Executive Vice President—Supermarkets

Stuart S. Tarrant
Executive Vice President—
Finance and Administration

Ernest H. Berthold
Senior Vice President—Merchandising

Caryle J. Sherwin
Senior Vice President—Operations

Vincent J. Veninata
Senior Vice President—
Supermarket Services

James M. Hayes
Vice President—Real Estate and
Store Development

Bertram S. Kaiser
Vice President—Grand Way Division

J. Barron Leeds
Vice President—Labor Relations

John D. O'Connell
Vice President—Grand Properties Division

Rodney L. Renné
Vice President—Distribution

William K. Rotert
Vice President—Operations Control

Russell W. Schroeder
Vice President—Management
Information Systems

Earl R. Silvers, Jr.
Vice President and Secretary

Vito A. Cardace
Controller

Roger W. Kennedy
Treasurer

Baxter T. Duffy
Assistant Secretary

Frederick H. Guntsch
Assistant Secretary

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THE GRAND UNION COMPANY

ELMWOOD PARK, N. J. 07407

PRESIDENT AND CHIEF EXECUTIVE OFFICER

June 2, 1978

The Grand Union Company had net income of $14,742,000 on sales of $1,649,274,000 during the 52-week 1977 fiscal year which ended on April 1, 1978. While this return on sales of 0.9% compares most favorably with most large American food chains, it does represent a drop from the unusually good $17,618,000 in net earnings recorded by the company during the previous year.

The Supermarket Division, which accounts for more than 95% of the company's total sales, experienced most of the shortfall in earnings. It was especially hindered by sharply rising expenses across the board and a general restraint in food price inflation which tends to soften proper volume development.

In most of its operating areas, Grand Union faced severe competitive conditions with price wars and costly sales promotion tactics, particularly an expensive offering of double — and sometimes triple — value on manufacturer's cents off coupons.

To combat this trend, Grand Union adopted a policy of taking a sensible approach on margins and sales promotion expenses, accepting a lower than budgeted sales level in order to accomplish the best possible "bottom line" results while at the same time maintaining our relative market position.

The company's general merchandise operations, Grand Way discount stores and Grand Catalog Showrooms, showed good results.

Grand Union opened 10 new supermarkets in 1977, most of them in the 28,000 square-foot class, while undertaking major renovations of another 28 units and enlarging four others. Fifteen older, obsolete and loss-making stores were closed.

This year, the company plans to open 20 new units, renovate 29 stores and enlarge five others. This continues a $150-million capital development program undertaken by the company two years ago.

A major restructuring of executive responsibilities occurred during the year to effect an orderly transition of responsibilities within the corporate structure as a number of younger executives were promoted into positions of greater responsibility.

Those promoted included Patrick A. Deo to Executive Vice President and Chief Operating Officer; Alan C. Goulding to Executive Vice President in charge of the Supermarket Division; Stuart S. Tarrant to Executive Vice President in charge of Finance and Administration; Caryle J. Sherwin to Senior Vice President in charge of Operations and Vincent J. Veninata to Senior Vice President in charge of Supermarket Services.

In addition, James M. Hayes was promoted to a Corporate Vice President in charge of Real Estate and Store Development and William K. Rotert was named Corporate Vice President in charge of Operations Control.

An emphasis this year will be placed on correcting certain weaknesses in some operating areas. Overall, the company is well poised to meet the economic and operating challenges which lie ahead.

James Wood

James Wood
President and Chief Executive Officer

Consolidated Statement of Income and Retained Earnings

The Grand Union Company and Subsidiaries
(Amounts in thousands)

	52 weeks ended	
	April 1, 1978	*April 2, 1977*
Sales	**$1,649,274**	$1,622,633
Cost of sales	**1,283,853**	1,266,057
Gross profit	**365,421**	356,576
Operating, administrative and general expenses (notes 9 and 10)	**343,487**	325,753
Interest expense	**5,053**	3,038
Interest income, principally on temporary cash investments	**(5,361)**	(2,453)
Income before income taxes	**22,242**	30,238
Income taxes (notes 2 and 4)	**7,500**	12,620
Net income	**14,742**	17,618
Retained earnings, beginning of year	**70,596**	58,976
	85,338	76,594
Less cash dividends:		
Common	**2,265**	5,919
Preferred	**78**	79
	2,343	5,998
Retained earnings, end of year	**$ 82,995**	$ 70,596

See accompanying notes to financial statements

Consolidated Balance Sheet

The Grand Union Company and Subsidiaries
(Amounts in thousands)

	April 1, 1978	*April 2, 1977*
ASSETS		
Current assets:		
Cash (note 8)	$ 155	$ 4,272
Temporary cash investments, at cost (approximates market value)	99,655	62,950
Accounts receivable	7,255	6,347
Inventories (note 2)	171,752	157,585
Prepaid taxes, operating supplies and other	9,956	10,392
Properties to be sold within one year	2,083	2,756
Total current assets	290,856	244,302
Property, net (notes 2 and 3)	105,088	104,505
Cost in excess of net assets of businesses acquired (note 2)	7,412	7,412
Investments, at cost and other assets	10,094	2,149
	$ 413,450	$ 358,368
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$ 132,883	$ 114,125
Federal income taxes (notes 2 and 4)	4,080	5,105
Total current liabilities	136,963	119,230
Notes payable (note 7)	65,000	50,285
Other non-current liabilities	1,494	1,644
Deferred federal income taxes (notes 2 and 4)	14,204	13,950
Long term lease obligations	10,110	—
	227,771	185,109
Stockholders' equity:		
4½% cumulative preferred stock, $50 par value, callable at $52 per share; authorized 116,000 shares, issued 34,657 and 35,409 shares respectively (note 5)	1,728	1,770
Common stock, $5 par value, authorized 9,000,000 shares, issued 6,265,346 and 6,609,078 shares respectively (notes 5 and 6)	31,327	33,045
Additional paid-in capital (note 5)	69,629	74,178
Retained earnings (note 7)	82,995	70,596
	185,679	179,589
Less, treasury stock at cost (note 5)	—	6,330
Total stockholders' equity	185,679	173,259
	$ 413,450	$ 358,368

See accompanying notes to financial statements

Consolidated Statement of Changes in Financial Position

The Grand Union Company and Subsidiaries
(Amounts in thousands)

	52 weeks ended	
	April 1, 1978	*April 2, 1977*
FUNDS PROVIDED:		
Net income	**$ 14,742**	$ 17,618
Charges to income not affecting working capital:		
Depreciation and amortization	**18,071**	17,507
Deferred federal income taxes	**683**	401
Working capital provided from operations	**33,496**	35,526
Book value of property sales and reductions	**8,715**	4,659
Increase in long term debt	**15,000**	15,000
Long term capital lease obligations	**10,110**	—
	67,321	55,185
FUNDS USED:		
Dividends	**2,343**	5,998
Property additions	**21,838**	24,845
Capitalized leases	**5,531**	—
Increase in investments and other assets	**8,374**	—
Others, net	**414**	(1,213)
	38,500	29,630
Increase in working capital	**$ 28,821**	$ 25,555
CHANGES IN WORKING CAPITAL:		
Increase (decrease) in current assets:		
Cash	**$ (4,117)**	$ 1,109
Temporary cash investments	**36,705**	28,063
Accounts receivable	**908**	163
Inventories	**14,167**	14,602
Prepaid taxes, operating supplies and other	**(436)**	(1,235)
Properties to be sold within one year	**(673)**	2,205
	46,554	44,907
Increase (decrease) in current liabilities:		
Accounts payable and accrued liabilities	**18,758**	22,396
Federal income taxes	**(1,025)**	(3,044)
	17,733	19,352
Increase in working capital	**$ 28,821**	$ 25,555

See accompanying notes to financial statements

NOTE 1 - ORGANIZATION:

On July 29, 1977, pursuant to a merger agreement, Cavenham Limited, through subsidiary companies (Cavenham (Overseas) Limited, Cavenham Holdings Inc., and Cavenham (USA) Inc.) acquired the remaining 19% minority interest outstanding in the Company's common stock, at which time, the Company became a wholly-owned subsidiary of Cavenham (USA) Inc. In connection with the merger and a prior exchange offer, certain restrictions were imposed on the Company, including among others, limitations on its ability to incur additional debt and to issue additional stock.

NOTE 2 - SUMMARY OF ACCOUNTING POLICIES:

The significant accounting principles affecting the Company's financial statements are summarized below.

Fiscal Year: The Company's fiscal year ends on the Saturday nearest the last day of March.

Principles of Consolidation: The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Intercompany transactions and balances have been eliminated.

Inventory Valuations: Inventories are valued at the lower of cost or market value, using the retail method for store inventories, and average cost for warehouse and other inventories.

Property: The costs of significant additions, renewals and improvements of leased and owned properties are capitalized. Depreciation is computed, principally on the straight line method, to amortize the cost of depreciable properties over their useful lives. Properties held under capital leases for leasing transactions entered into subsequent to December 31, 1976 are capitalized, net of any gains on sale and leaseback transactions. Such capitalized leases are depreciated using the straight line method over the life of the lease. Leasehold improvements are amortized over the shorter of the terms of the leases or their estimated useful lives. Maintenance and repairs which do not improve or extend the life of the respective assets are charged to expense when incurred.

Pre-Opening Costs: Store pre-opening costs and carrying charges relating to land held for development or sale are charged to expense as incurred.

Cost in Excess of Net Assets of Businesses Acquired: Management does not believe that such amounts, which arose from acquisitions prior to November 1, 1970, have diminished in value and accordingly is not amortizing such amounts.

Income Taxes: The Company is a party with Cavenham (USA) Inc. and Cavenham Holdings Inc. to a tax sharing agreement whereby the consolidated operations of the Company will be included in consolidated tax returns filed by Cavenham Holdings. Under the agreement, the Company receives tax sharing payments equal to 15% of the amount, if any, by which the Company's consolidated federal income tax exceeds the actual consolidated tax liability. Such sharing payments are applied as a reduction of the Company's consolidated federal income tax provision.

Differences between income taxes provided on financial statement income and the actual amounts payable result in adjustments to the deferred or prepaid tax accounts. Such differences arise primarily through the use of accelerated methods of depreciation for tax purposes and the recording of certain reserves for financial statement purposes which are not deductible for tax purposes until the expenses are actually incurred. Investment tax credits are accounted for as a reduction of income taxes in the year that the credits arise.

Pension Plan: The Company maintains a non-contributory, trusteed pension plan for eligible employees. The Company's policy is to fund pension costs accrued. Pension expense under the plan consists of normal cost adjusted for amortization of past service costs over a forty year period.

NOTE 3 - PROPERTY:

Property, at cost, consists of the following:

	April 1, 1978	*April 2, 1977*
	(in thousands)	
Land	$ 4,869	$ 6,234
Buildings	4,381	6,048
Fixtures and equipment	177,012	174,434
Leasehold improvements	40,893	41,163
	227,155	227,879
Less - accumulated depreciation and amortization	127,598	123,374
Property owned	99,557	104,505
Property held under capital leases	5,531	—
	$105,088	$104,505

NOTE 4 - INCOME TAXES:

The components of income tax expense are as follows:

	52 weeks ended	
	April 1, 1978	*April 2, 1977*
	(in thousands)	
Federal income tax expense		
Currently payable net of tax sharing credit	$ 6,873	$ 8,615
Deferred, consisting of:		
Excess of tax over book depreciation	1,200	480
Other	(2,030)	1,567
State income tax	1,457	1,958
Total income tax provision	$ 7,500	$ 12,620

The reconciliation of the provision for income taxes computed at the federal statutory rate to the reported provision for federal and other income taxes is as follows:

	52 weeks ended April 1, 1978	52 weeks ended April 2, 1977
	(in thousands)	
Provision computed at 48% of pre-tax income	$ 10,676	$ 14,514
Increase (decrease) in the provision resulting from:		
Tax sharing benefits	(698)	(461)
Current year's investment tax credit	(1,600)	(1,900)
Utilization of capital loss carry-forwards	(949)	—
State and local taxes, net of federal tax benefit	758	1,018
Others, net	(687)	(551)
	$ 7,500	$ 12,620

NOTE 5 - STOCKHOLDERS' EQUITY:

Changes in additional paid-in capital and treasury stock are as follows:

	Paid-in Capital	Treasury Stock
	(in thousands)	
Balance April 3, 1976 (includes 390,922 common shares held in Treasury)	$ 74,310	$ 7,117
Issuance of 18,965 common shares for exercised stock options	(127)	(345)
Purchase of 435 shares of preferred stock	—	13
Sale of 25,000 common shares to Cavenham Holdings	(5)	(455)
Balance April 2, 1977 (includes 346,957 common shares and 435 preferred shares held in Treasury)	74,178	6,330
Purchase of 407 shares of preferred stock	—	16
Issuance of 3,225 common shares for exercised stock options	(22)	(59)
Retirement of 343,732 common shares and 842 preferred shares held in treasury	(4,527)	(6,287)
Balance April 1, 1978	$ 69,629	$ —

NOTE 6 - STOCK OPTIONS:

During the year ended April 1, 1978, options to purchase 3,225 shares were exercised and 900 options were cancelled under the Company's non-qualified stock option plan. On July 29, 1977, effective with the merger, the Company's stock option plan was terminated.

NOTE 7 - LONG TERM DEBT:

On August 1, 1977, the Company increased its borrowings by $15,000,000 under the terms of its 8.4% Note Agreement. The agreement requires annual repayments of principal from 1984 to 1997 increasing from $4,000,000 to $5,000,000 and contains certain dividends and other restrictions. At April 1, 1978 approximately $25,500,000 of retained earnings were free for distribution.

NOTE 8 - COMPENSATING BALANCES AND BORROWING ARRANGEMENTS:

The Company has borrowing arrangements with a number of banks aggregating $13,400,000. To the extent that compensating balances are maintained, a substantial portion of such balances would normally be covered by incompleted transactions with banks.

NOTE 9 - PROPERTY LEASES:

The Company operates principally in leased stores, distribution facilities and offices and, in most cases, holds renewal options with varying terms. Many of the leases contain escalation clauses which provide for increased rentals based upon increases in real estate taxes and lessors' operating expenses.

Total rental expense was as follows:

	52 weeks ended April 1, 1978	52 weeks ended April 2, 1977
	(in thousands)	
Minimum annual rents on non-cancellable capital leases (net of sublease rental income of $674,000 and $586,000 respectively)	$ 4,323	$ 4,412
Minimum annual rents on other leases (net of sublease rental income of $1,579,000 and $1,095,000 respectively)	24,275	24,522
Contingent rentals on non-cancellable capital leases (no sublease rental income)	27	33
Contingent rentals on other leases (no sublease rental income)	1,538	1,507
Total rental expense	$ 30,163	$ 30,474

Minimum annual rents, not including real estate taxes and additional payments based on percentages of sales, are as follows:

	April 1, 1978		
	Capital	Operating	Total
		(in thousands)	
1978	$ 5,574	$ 20,903	$ 26,477
1979	5,349	19,297	24,646
1980	5,123	17,818	22,941
1981	4,950	16,390	21,340
1982	4,707	14,896	19,603
Remainder	40,617	106,484	147,101
Total minimum rental payments	66,320	195,788	262,108
Less: sublease rental income	5,436	7,492	12,928
	$ 60,884	$188,296	$249,180

During 1976, the Financial Accounting Standards Board issued Financial Accounting Standards No. 13 (FAS 13) requiring capitalization of appropriate leases as asset acquisitions with related debt assumption. The following table sets forth the amounts of assets and liabilities that would have been reflected in the accompanying balance sheet for leases entered into prior to January 1, 1977 in accordance with the provisions of FAS 13. Retroactive application of FAS 13 would not have a material effect on net income.

	April 1, 1978	April 2, 1977
	(in thousands)	
Property held under capital leases	$ 41,522	$ 42,048
Accumulated depreciation	17,988	16,618
Capital lease obligations:		
Current	2,439	2,056
Long-term	26,475	28,820

The following is a schedule of future minimum lease payments for property held under capital leases executed after January 1, 1977, with the present value of the net minimum lease payments as of April 1, 1978.

Fiscal Year	(in thousands)
1978	$ 1,054
1979	1,054
1980	1,054
1981	1,054
1982	1,054
Remainder	17,164
Total minimum payments	22,434
Less: executory costs	1,129
imputed interest	10,969
Total present value (includes $226,000 current and $10,110,000 noncurrent obligations)	$10,336

NOTE 10 - PENSION PLAN:

Pension expense under the Company's noncontributory plan was $2,640,000 and $2,460,000 for the 52 weeks ended April 1, 1978, and April 2, 1977, respectively. There are no unfunded vested benefits.

NOTE 11 - CONTINGENCIES:

The Company has been named as a co-defendant in numerous similar antitrust actions brought by producers and feeders of cattle. Each of the actions allege violations by the defendants of the federal antitrust laws in connection with the purchase and sale of beef and seeks damages and injunctive relief. Certain of these lawsuits have been dismissed and are presently on appeal. The remaining lawsuits are in early pre-trial stage. It is not possible to predict with any degree of certainty the ultimate outcome of any of these lawsuits since, among other things, the conduct of the other defendants as alleged co-conspirators could affect the liability of the Company. The management of the Company believes that the Company has good and meritorious defenses to each of such lawsuits.

In addition, a purported class and derivative action has been brought against the Company and its parents seeking the rescission of the merger referred to in Note 1 and the recovery of unspecified damages, costs and attorneys' fees. The Company and its parents believe that its actions have been entirely proper and lawful and intends to defend the lawsuit vigorously.

NOTE 12 - ASSET REPLACEMENT COST (UNAUDITED):

The Company's annual report on Form 10-K contains estimated additional costs which would be required if the Company were to replace its inventory and productive capacity at April 1, 1978, and the related estimated effect of such costs on depreciation expense and cost of sales.

Replacement cost of inventories and cost of sales closely approximated the amounts reported on the consolidated balance sheet and income statement due to the relatively short time lag between incurring inventory costs and their subsequent conversion into sales revenue.

Although the cumulative impact of inflation over a number of years has resulted in a substantially greater capital investment to replace productive capacity compared to historical cost, such greater replacement costs were partially offset by technological improvements and design changes which often resulted in increased productivity and a maintenance of the Company's profit margin.

Regulations promulgated by the Securities and Exchange Commission governing replacement costs do not specify uniform procedures for development of replacement costs. In addition, the above information necessarily reflects the subjective judgment of management and estimations based on available information.

Price Waterhouse & Co.

411 Hackensack Avenue
Hackensack, New Jersey 07601
May 1, 1978

To The Board of Directors and Stockholders of The Grand Union Company

In our opinion, the accompanying consolidated balance sheet and the related consolidated statements of income and retained earnings and of changes in financial position present fairly the financial position of The Grand Union Company and its subsidiaries at April 1, 1978 and April 2, 1977, and the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied. Our examinations of these statements were made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

Price Waterhouse & Co

Management Discussion and Analysis of the Consolidated Statement of Income and Retained Earnings

General

The improved performance that the Company has experienced in recent years is primarily related to increased gross profits, together with certain profit improvement programs, including the closing of unprofitable stores, discontinuance of trading stamp programs, and labor cost reductions, all of which were implemented since Cavenham Limited purchased its initial investment in Grand Union and restructured its management.

Fiscal Year 1977 vs. Fiscal Year 1976

Net income declined as compared to the preceding year reflecting the effects of higher operating, administrative and general expenses, specifically labor and utility costs, and by the increased competition in most of the chain's areas of operation.

Sales for fiscal 1977 increased only slightly over fiscal 1976, although gross profit as a percent of sales remained level with the preceding year.

The increase in interest expense reflects the higher level of indebtedness during the current year. The increase in interest income is due to the higher level of temporary cash investments and interest rates during the current year.

The effective tax rate for 1977 was 34% as compared to 42% for 1976. The decrease resulted from a non-recurring tax benefit arising from utilization of capital loss carryforwards and the relatively higher benefits of the Company's share of tax savings as a participant in the Holdings tax sharing agreement.

Fiscal Year 1976 vs. Fiscal Year 1975

The increase in net income as compared to the preceding year is primarily related to increased gross profits, together with certain profit improvement programs, including closing of unprofitable stores, discontinuance of trading stamp programs, and labor cost reductions.

Sales for fiscal 1976 increased only slightly over fiscal 1975, though gross profit as a percent of sales increased 1.1%, primarily due to the opening of larger stores and renovating and enlarging of existing stores, thereby increasing flexibility in the products offered for sale in the stores.

The increase in operating, administrative and general expense reflects higher employment costs, increased advertising costs and higher store occupancy costs.

The loss on disposition of fixed assets primarily reflects the provision for net gains and losses on supermarket closings and/or renovations which is dependent on the age and size of the individual stores.

The decrease in interest expense resulted from a decrease in average indebtedness during the year.

The effective tax rate for 1976 was 42% as compared to 45% for 1975, which resulted from the tax savings as a participant in the Cavenham Holdings tax sharing agreement and a relatively higher investment tax credit.

Five-Year Financial Summary

The Grand Union Company and Subsidiaries
(Amounts in thousands)

For the Fiscal Year Ended	*April 1, 1978*	*April 2, 1977*	*April 3, 1976 (a)*	*March 1, 1975*	*March 2, 1974*
Sales	**$1,649,274**	$1,622,633	$1,611,195	$1,562,736	$1,493,969
Cost of sales	**1,283,853**	1,266,057	1,274,485	1,228,744	1,177,442
Gross profit	**365,421**	356,576	336,710	333,992	316,527
Operating, administrative and general expenses	**343,487**	325,753	306,661	307,697	301,422
Other deductions (income):					
Provision for store closings	—	—	8,150	2,093	9,039
Write-down of preferred stocks	—	—	—	4,619	1,864
Interest expense	**5,053**	3,038	3,414	4,880	2,610
Interest income, principally on temporary cash investments	**(5,361)**	(2,453)	(2,651)	(2,318)	(663)
Dividends from investments	—	—	—	(1,279)	(699)
Income before income taxes	**22,242**	30,238	21,136	18,300	2,954
Provision for income taxes	**7,500**	12,620	9,449	8,796	645
Net income	**$ 14,742**	$ 17,618	$ 11,687	$ 9,504	$ 2,309
Net income as a percent of sales	**.89%**	1.09%	.73%	.61%	.15%
At the Year End					
Ratio of current assets to current liabilities	**2.12 to 1**	2.05 to 1	2.00 to 1	2.07 to 1	1.87 to 1
Number of stores at year end:					
Supermarkets	**479**	484	487	503	531
Grand Way stores	**14**	14	14	14	23
Grand Catalog Showrooms	**9**	9	9	17	18

a) 53-week fiscal year